IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

NO. .....

PRESSED STEEL CAR COMPANY, INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Opinions Below.

The opinion of the Tax Court of the United States was entered on August 16, 1944, but is not officially reported. The opinion of the Circuit Court of Appeals was entered on December 26, 1945, and is reported at 152 F. (2d) 280.

Jurisdiction.

The judgment sought to be reviewed is a final judgment of the United States Circuit Court of Appeals for the Third Circuit affirming, without discussion, a decision of the Tax Court. The jurisdiction of this Honorable Court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U.S.C. 347(a), and Section 1141 of the Internal Revenue Code, 26 U.S.C. 1141(a).

Statute Involved.

The statute involved is Section 114(a) of the Revenue Act of 1936, as amended, 49 Stat. 1686, 26 U.S.C.A., Internal Revenue Acts, p. 866 *et seq.*, and Section 113 of the Revenue Act of 1936, 49 Stat. 1686, 26 U.S.C.A., Internal Revenue Acts, page 859 *et seq.*

Statement.

The essential facts are summarized in the Petition for Certiorari under the title "Summary Statement of the Matter Involved", *supra,*

Specification of Errors.

The Circuit Court of Appeals erred as follows:

1. In holding that there is to be excluded from the basis of depreciation (i. e., the cost) of property in the hands of a purchaser that part of the price paid therefor by the purchaser which the seller had agreed to and did pay to a third party as compensation for services in negotiating the sale.

2. In holding that where there is substantial evidence before the Tax Court contradicting a determination in a final notice of deficiency of the Commissioner of Internal Revenue, the determination of the Commissioner of Internal Revenue may nevertheless be given evidentiary effect by treating it as evidence of the correctness of the facts set forth in such notice of deficiency.

3. In holding that where the opinion of the Tax Court conclusively shows that it did not understand the valuation issue before it and its opinion expressly states that its ruling on such issue is based on its mistaken understanding thereof, there was no substantial departure by the Tax Court from the accepted and usual course of judicial proceedings which should have been corrected by the Circuit Court.

Summary of Argument.

(a) The purchaser of depreciable property is entitled to depreciate the entire cost thereof. The fact that the seller of such depreciable property pays a part of the amount received by him as the purchase price therefor to a third party as a commission for services in negotiating the sale does not result in an equivalent reduction in the purchaser's cost (i. e., the purchase price) of such property.

(b) The presumption of correctness accorded to a determination made in a formal notice of deficiency by the Commissioner of Internal Revenue in a proceeding before the Tax Court is destroyed when substantial evidence is introduced that the facts so determined by the Commissioner of Internal Revenue are incorrect and no

evidentiary effect can thereafter be given to such determination.

(c) The Circuit Court sanctioned a departure by the Tax Court from the accepted and usual course of judicial proceedings which gravely and seriously affected petitioner in that it deprived petitioner of the right to depreciate more than $5,000,000 of its investment in depreciable assets. Such departure resulted from its plainly disclosed misunderstanding of the issue presented to it for decision.

ARGUMENT.

I.

The Decision of the Circuit Court Is in Conflict with Applicable Decisions of This Court.

The decision of the Circuit Court affirming that of the Tax Court is clearly in conflict with the decision of this Court in *Detroit Edison Co. v. Commissioner of Internal Revenue,* 319 U. S. 98, 63 S. Ct. 902 (1943).

The facts relating to the securities issued by petitioner to its predecessor in exchange for the assets of such predecessor are not in dispute, all such facts having been stipulated before the Tax Court. The petitioner issued 268,706.9 shares as well as other securities to the reorganization trustees of the predecessor in exchange for the assets of such predecessor and also assumed certain liabilities. The Plan of Reorganization contained an agreement between the reorganization trustees and an investment syndicate headed by General American Transportation Corporation that the reorganization trustees would, as compensation for the services of the

investment syndicate in connection with the reorganization if the Plan of Reorganization was confirmed, deliver 30,000 of the 268,706.9 shares of such Common Stock to be received by the reorganization trustees to the investment syndicate. The Plan was confirmed and the securities mentioned were delivered to the reorganization trustees in exchange for the assets. The reorganization trustees thereupon turned over the 30,000 shares of Common Stock to the investment syndicate. In determining petitioner's basis for depreciation which, under Sections 114(a) and 113(b) of the 1936 Revenue Act (26 U.S.C.A., Internal Revenue Acts, Pages 859, 866), was the cost of acquiring such depreciable assets, the Commissioner excluded from such cost the fair market value, on the effective date of the reorganization, of such 30,000 shares of petitioner's Common Stock. The Tax Court sustained the Commissioner in excluding such amount from the cost of the depreciable assets so acquired and the action of the Tax Court was affirmed by the Circuit Court. This Court in *Detroit Edison Co. v. Commissioner, supra,* defined "cost" as meaning the amount paid to acquire property. The fact that a commission may be paid by the seller of property to the broker or other person who negotiated the sale or participates in the sale cannot under the decision of this Court be applied in reduction of a purchaser's outlay. Whatever the purchaser pays to the seller constitutes the purchaser's cost.

II.

The Decision of the Circuit Court Is in Conflict with Applicable Decisions of Other Circuit Courts of Appeals on the Same Matter.

The decision of the Circuit Court which affirmed the decision of the Tax Court rules that where a commission is paid by the seller of property out of the purchase price paid by the purchaser for such property, the amount of such commission reduces the cost incurred by the purchaser in acquiring such property. This decision of the Circuit Court is in direct conflict with *Commissioner v. Schumacher Wall Board Corp.*, 39 F.(2d) 79 (C.C.A. 9, 1937) and *Champlin Refining Company v. Commissioner*, 123 F.(2d) 202 (C.C.A. 10, 1941). The decision of the Circuit Court is also in direct conflict with its own previous decisions in *Forstmann v. Rogers*, 128 F.(2d) 126 (C.C.A. 3, 1937) and *Hazeltine Corporation v. Commissioner*, 89 F. (2d) 513 (C.C.A. 3, 1937).

The principal issue in *Commissioner v. Schumacher Wall Board Corporation, supra,* was the determination of the basis for depreciation (i.e., the cost) of certain assets. Schumacher Wall Board Corp. (herein called Schumacher) issued all of its stock to Corporation A in consideration for the transfer to Schumacher of all of the assets of Corporation A plus the agreement of Corporation A to cause certain patents, which did not then belong to Corporation A, to be assigned to Schumacher. Such patents were owned at the time by the Corporation A stockholders. Such stockholders agreed to sell their patents and all of the stock in Corporation A to Corporation B for approximately $1,500,000 in cash. When Corporation A received the Schumacher stock it

immediately transferred such stock to Corporation B as consideration for the execution and delivery to Corporation A of Corporation B's promissory note and an agreement by Corporation B to transfer the patents which now belonged to Corporation B to Schumacher. By virtue of these agreements relating to the transfer of the patents, the patents were transferred to Schumacher when Corporation B paid the above-mentioned $1,500,000. Corporation A then dissolved and in the course of its liquidation Corporation B's promissory note was returned to Corporation B. Immediately after Corporation B had received all of the stock of Schumacher, it transferred a substantial part of that stock to three other corporations, C, D and E, pursuant to a pre-arranged plan. The net result of these various steps was that Schumacher had the patents and owned all of the assets of Corporation A and Corporation B and Corporations C, D and E owned all of the Schumacher stock. The Commissioner claimed that since the stockholders of Corporation A, who had owned the patents involved, transferred those patents directly to Schumacher, the cost of such patents was the amount which Corporation B had paid to such stockholders for the patents. The Circuit Court of Appeals for the Ninth Circuit held that the cost of the patents to Schumacher was the value of the stock which it had issued in exchange therefor.

In *Champlin Refining Co. v. Commissioner, supra,* the Circuit Court of Appeals for the Tenth Circuit held that "where property is given in exchange for other property, the cost of the property acquired is the value of the property given in exchange therefor." In the instant case the Tax Court made no effort to determine the value of the property (i.e., its securities) given by peti-

tioner in exchange for the assets of its predecessor, although there was substantial evidence in the record as to the value of such securities.

In *Hazeltine Corp. v. Commissioner, supra,* and *Forstmann v. Rogers, supra,* the Circuit Court of Appeals for the Third Circuit held specifically that the cost of property is the amount paid by the purchaser to the seller notwithstanding any disposition which the seller may make of the amount so received to other persons.

III.

The Decision of the Circuit Court Sanctions Such Departure from the Accepted and Usual Course of Judicial Proceedings as to Call for an Exercise of This Court's Power of Supervision.

The Tax Court had before it a stipulation of facts which included evidence as to sales on the New York Stock Exchange of securities which were freely convertible into the securities issued by petitioner in exchange for its assets. The Tax Court also had before it expert testimony as to the fair market value of the petitioner's securities which were so issued. The Tax Court erroneously supposed that the issue presented to it was one requiring the determination of the fair market value, on the effective date of the reorganization, *of the assets which the predecessor transferred to the petitioner rather than the determination of the fair market value of the property (i.e., the securities) which the petitioner transferred to its predecessor in exchange for the predecessor's assets.* This admits of no dispute because, as is

pointed out above, the opinion of the Tax Court expressly states that it was asked "to fix the fair market value of the transferred assets". The Tax Court also expressly declared that it was not required to give any weight to the testimony of the expert witnesses because they did not attempt to express an opinion as to the fair market value of the assets transferred to the petitioner. The Tax Court made no comment whatever about the evidence as to the fair market value of petitioner's securities which was afforded by the selling price on the New York Stock Exchange of other securities which were freely convertible into petitioner's securities, and has clearly ignored that evidence completely. The evidence of the New York Stock Exchange sales, as well as the evidence afforded by the testimony of the expert witnesses, was in direct conflict with the determination made by the Commissioner of Internal Revenue in his formal notice of deficiency. There was no other evidence in the record to support the determination so made by the Commissioner of Internal Revenue. The effect of the Tax Court's action in disregarding entirely the evidence of the New York Stock Exchange sales and the testimony of the expert witnesses was to give to the determination of the Commissioner of Internal Revenue the force and effect of evidence. It is well-established that the presumption of correctness which attaches to the determination by the Commissioner of Internal Revenue in a notice of deficiency is destroyed when evidence contradicting or showing the incorrectness of his determination is introduced in evidence: *J. M. Perry & Co., Inc., v. Commissioner*, 120 F. (2d) 123 (C.C.A. 9, 1941); *Mertens, Law of Federal Income Taxation* (1943), Vol. 9, Sections 50.69, 50.71.

As a result of its misapprehension as to the nature of the issue presented to it, the Tax Court's decision was made without regard to the uncontradicted evidence which related to the fair market value of the securities which petitioner issued in exchange for its predecessor's assets. The appropriate method of determining the cost of such assets was to determine the value of the property (securities) that the petitioner gave in exchange for such assets. Since there was evidence of such value, the Tax Court was bound to consider it, but because it thought that the dispute between the petitioner and the Commissioner of Internal Revenue related to the value of the assets at the time of the exchange rather than the amount paid therefor by the petitioner, it departed widely from the usual and accepted course of judicial proceedings, which departure should have been corrected by the Circuit Court. It is clear from the record of the proceedings below (R. 6 a, 8 a) that the effect of the Tax Court's deviation from the usual and accepted course of judicial proceedings will be to deprive petitioner of the advantage of deductions for depreciation in computing its Federal tax liabilities with respect to more than $5,000,000 of its investment in its depreciable properties and, for the taxable year ended December 31, 1936, deprives the petitioner of a deduction for depreciation in excess of $152,000.

Such departure from the accepted and usual course of judicial proceedings should not be countenanced by this Court.

Respectfully submitted,

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